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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

July 29, 1996

EX PARTE

William F. Caton
Secretary
Federal Communications Commission
Room 222
1919 M. Street, N.W.
Washington, D.C. 20554

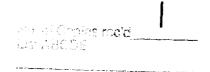   Re: CC Docket No. 96-98

Dear Mr. Caton:

The attached attached analysis of embedded tandem switch revenue requirement was faxed to Richard Metzger on July 28, 1996. This analysis clearly demonstrates that a calculation of a RIC for tandem switching results in a far lower charge than that which is currently assessed. Removal of transport related costs is the main reason for such a result.   In addition, proper application of TSLRIC pricing -- as required by Sections 251 and 252 of the Act -- would further reduce the charge.

Please place a copy of this notice and the attached in the record of this proceeding.

Sincerely,

Sincerely,

Calculation of Revenue Requirement Factor

The objective of calculating a revenue requirement is to relate all expenses to "primary" investments. The traditional "primary" investments (Class B account) are: Information Origination/Termination (IOT - 2310), Cable and Wire Facilities (C&WF - 2410), Central Office Transmission (2230), and Central Office Switching (2210). Primary expenses are those related to the non-investment expenses of Part 36 (separations) Big Three Expense Factor, i.e., Customer Operations Expenses. These expenses include: Marketing (6610) and Customer Services - (6623). Central Office Switching - Operator Systems (2220) and Call Completion (6621) and Number Services (6622) expenses can be treated as primary investment/expenses or associated with all primary investments/expenses. Once the "non-primary" investments/expenses have been allocated to "primary" investments/expenses, the "primary" expenses could be allocated to the "primary" investments to derive a fully distributed cost/"primary" gross investment. Class B accounting is used because Part 36 and therefore the ARMIS 43.04 does not require Class A detail to be used. "Subject to Separations" (Part 32 - Part 64 - SNFA - Other Adjustments) has been used in all calculations.

Bottoms Up

The first step is to allocate the "direct" expenses to the primary investment. Depreciation detail is sufficient to allocate the related depreciation expense to the primary investment. Plant specific expense is allocated per Part 36 and therefore the Plant Specific expenses for the individual Central Office pieces (6210+6220+6230) are allocated to total Central Office investment (2210+2220+2230). This common factor is applied to the individual central office investment pieces. Per Part 36, Network Operations is only allocated between IOT, C&WF and CO. The return amount is calculated at 11.25% based on net investment which is recalculated as a factor based on gross investment. Net investment is equal to gross investment less accumulated depreciation (3100) less deferred taxes (4100+4340). Because taxes are generally related to "profit" or return, the actual reported taxes are equated to the return component of the "primary" + GSF investments.

"Primary" + GSF Investment	Depreciation	Plant Specific	Network Operations	Return (11.25%) on Net Investment	Actual Taxes equated to Return
IOT	6560	6310	6530	X	X
C&WF	6560	6410	6530	X	X
CO					
Transmission	6560	6210+6220+6230	6530	X	X
Switching	6560	6210+6220+6230	6530	X	X
Op System	6560	6210+6220+6230	6530	X	X
GSF	6560	6110+6120		X	X

In separations and therefore the ARMIS 43.04, there is no distinction between tandem switching and local switching in the allocation of expenses, return and taxes. Each switching gross investment dollar gets the same amount of "expenses". For switching (and therefore tandem switching too), the individual revenue requirement factors for 1994 TBOC are: depreciation expense - $.095; plant specific expense - $.045; plant nonspecific (network operations) - $.030; return (11.25%) - $.049; and taxes - $..030, for a total of $.249.

Bottoms Up with 8% overheads

To "gross up" for overheads (8%), the plant specific and nonspecific expenses are multiplied by 1.08. From the previous discussion, the plant specific factor ($.045) becomes $.0486 and the plant nonspecific factor ($.030) becomes $.0324. Depreciation ($.095), return ($.049), and taxes ($.030) remains the same for a total of $.2550

The second step is to allocate the "Big 3 Expense" separated costs to the "Big 3 Expenses". GSF "costs" were calculated above and include depreciation, plant specific, return and taxes.

Big 3 Expenses	Corporate Operations	GSF "costs"
Plant Specific		
IOT	6710+6720	X
C&WF	6710+6720	X
COE	6710+6720	X
Plant NonSpecific		
Network Operations	6710+6720	X
Customer Operations		
Marketing	6710+6720	X
Telephone Operator	6710+6720	X
Pub Directory Listing	6710+6720	X
Services		
Local Business Office	6710+6720	X
Revenue Accounting	6710+6720	X
Other	6710+6720	X

The third step is to allocate the "operator" expenses (telephone operator and published directory listing) to operator systems investment. Because "operator" expenses are a part of "Big 3 Expenses" there will also be a "loading" for the "Big 3 Expense" separated expenses - Corporate Operations expense and GSF "costs". The fourth step is to allocate the "plant related" Big 3 Expenses (Plant Specific - IOT, C&WF, & CO and Plant NonSpecific - Network Operations) plus the Big 3 Expense separated "loadings" to the related primary investments. The last step is to move the remaining "non-plant related" Big 3 Expenses to the primary investments based on common per gross dollar of investment.

"Primary" Investment	"Operator" Expenses + "loadings"	"Plant related" Big 3 Expense + "loadings"	"Non plant related" Big 3 Expenses + "loadings"
IOT		X	X
C&WF		X	X
CO			
Transmission		X	X
Switching		X	X
Op System	X	X	X

Bottoms Up - including direct and indirect expenses, return and taxes

Cat 2 Investment	$	3,366,292,000
Cat 2 Rev Req Factor	$	0.249 Includes PI Sp, Dep, PI NSp, Return & Taxes
Cat 2 Revenue Req (RR)	$	838,206,708
Cat 2 Minutes		155,283,000,000
Cat 2 RR/Minute	$	0.005398
Rate	$	0.005398
Tandem Rate	$	0.001500
RIC (Rate - Tandem Rate)	$	0.003898

Based on 1994 TBOC ARMIS - 43.04

Bottoms Up - including direct, 8% overheads, return and taxes

Cat 2 Investment	$	3,366,292,000					
Cat 2 Rev Req Factor	$	0.255	includes PI Sp, PI NSp, and 8% overhead loading based on expenses, Dep, Return, Tax				
Cat 2 Revenue Req (RR)	$	858,404,460			To be grossed up		Includes gross up
			PI Sp	$	0.045	$	0.0486
Cat 2 Minutes		155,283,000,000	PI NSp	$	0.030	$	0.0324
			Dep			$	0.0950
Cat 2 RR/Minute	$	0.005528	Return			$	0.0490
			Taxes			$	0.0300
			Total			$	0.2550

Rate	$	0.005528
Tandem Rate	$	0.001500
RIC (Rate - Tandem Rate)	$	0.004028

Based on 1994 TBOC ARMIS - 43.04

Bottoms Up - including direct and indirect expenses, return and taxes - Net of SS7 and 800/888 database

Cat 2 Investment	$	3,366,292,000
Database Investment	$	192,117,927
Net Cat 2 Investment	$	3,174,174,073
Cat 2 Rev Req Factor	$	0.249 includes Pl Sp, Dep, Pl NSp, Return & Taxes
Net Cat 2 Rev Req	$	790,369,344
Cat 2 Minutes		155,283,000,000
Cat 2 RR/Minute	$	0.005090
Rate	$	0.005090
Tandem Rate	$	0.001500
RIC (Rate - Tandem Rate)	$	0.003590

Based on 1994 TBOC ARMIS - 43.04

Bottoms Up - including direct, 8% overheads, return and taxes - Net of SS7 and 800/888 database

					To be grossed up	Includes gross up
Cat 2 Investment	$	3,366,292,000				
Database Investment	$	192,117,927				
Net Cat 2 Investment	$	3,174,174,073				
Cat 2 Rev Req Factor	$	0.255	includes PI Sp, PI NSp, and 8% overhead loading based on expenses, Dep, Return, Tax			
Net Cat 2 Rev Req	$	809,414,389				
			PI Sp	$	0.045 $	0.0486
Cat 2 Minutes		155,283,000,000	PI NSp	$	0.030 $	0.0324
			Dep		$	0.0950
Cat 2 RR/Minute	$	0.005213	Return		$	0.0490
			Taxes		$	0.0300
			Total		$	0.2550
Rate	$	0.005213				
Tandem Rate	$	0.001500				
RIC (Rate - Tandem Rate)	$	0.003713				

Based on 1994 TBOC ARMIS - 43.04